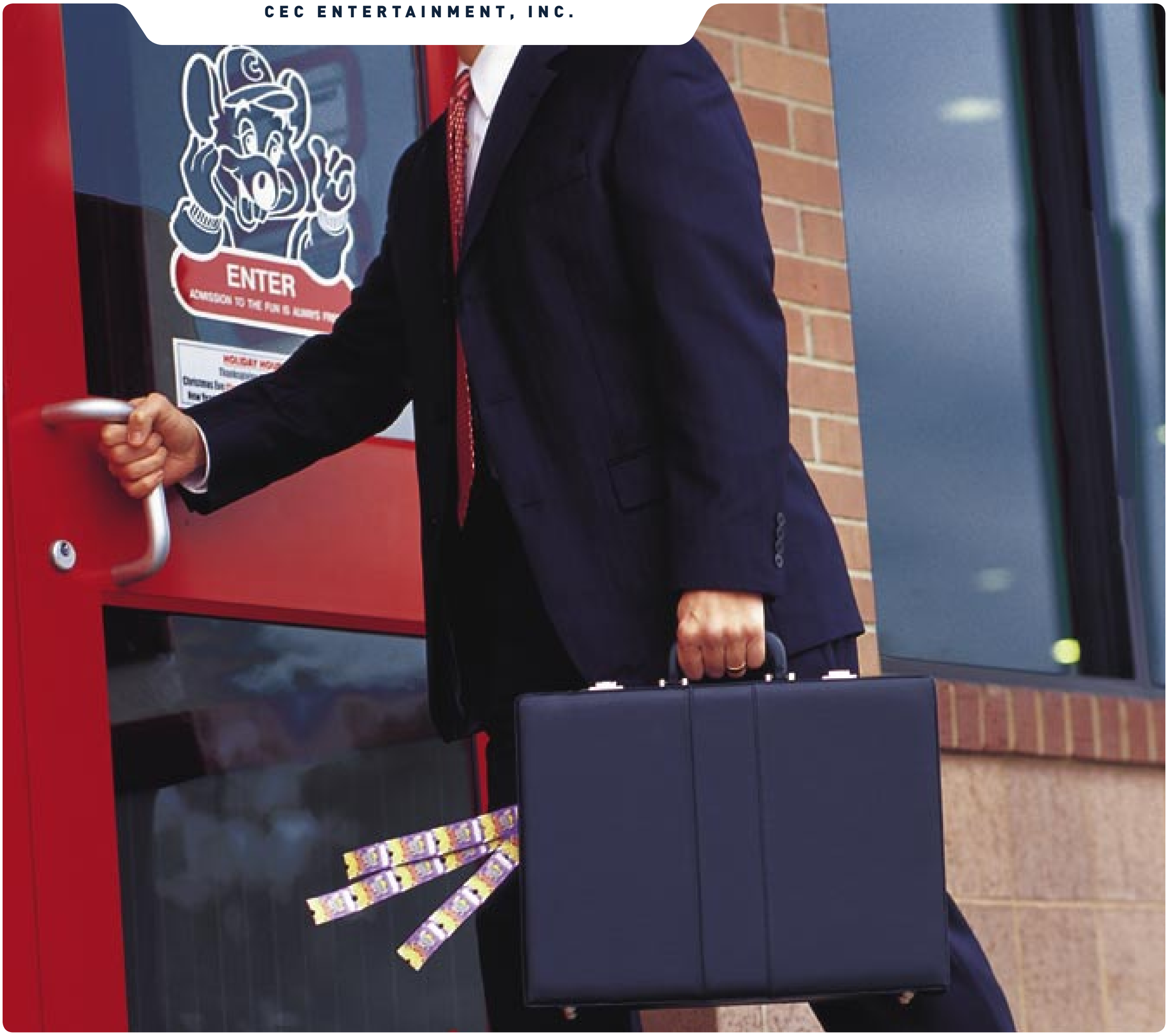
CEC ENTERTAINMENT, INC.



WE'RE ALL BUSINESS »



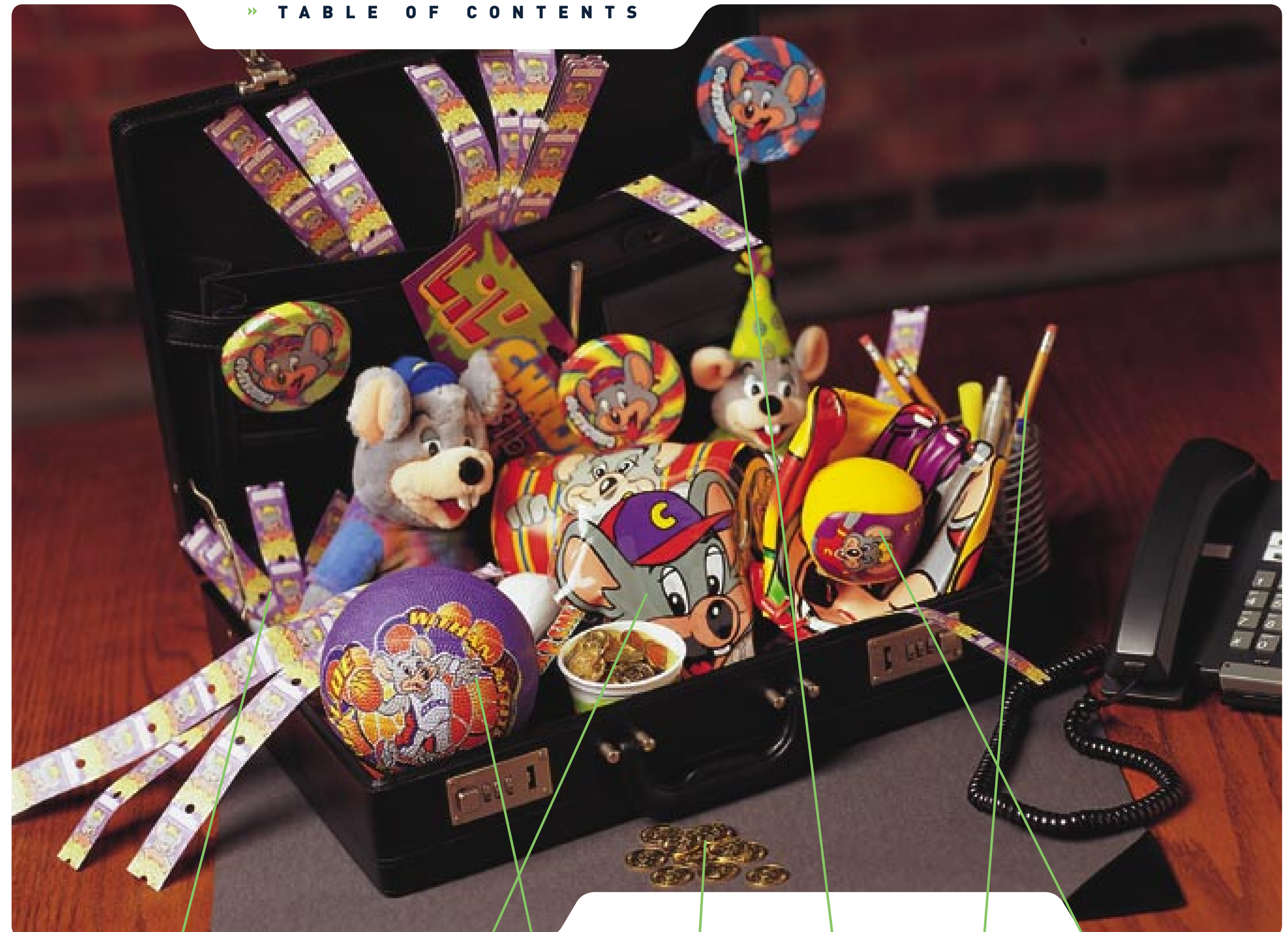
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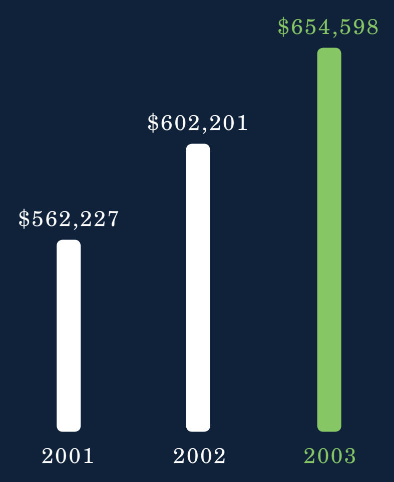


« HIGHLIGHTS

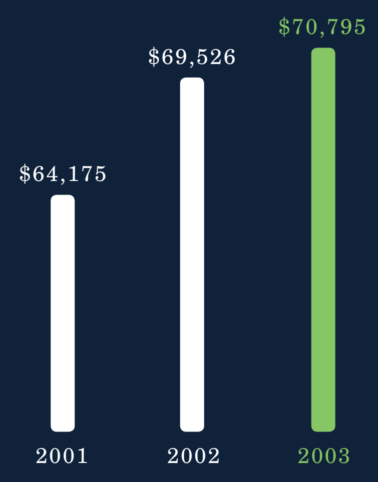
» when it comes to fun.

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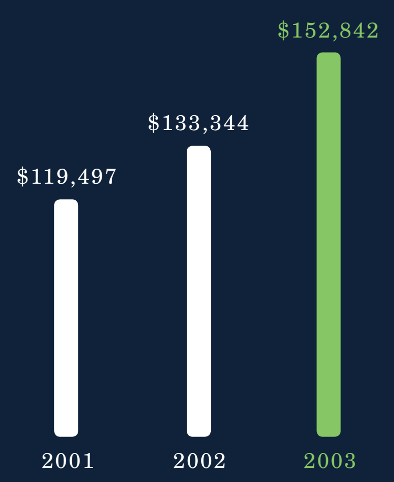




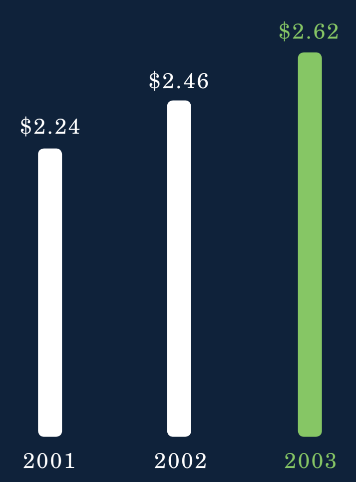
Revenues (in thousands)



Net Income (in thousands)



Cash Provided By Operations
(in thousands)



Diluted Earnings Per Share

In 2003, CEC Entertainment, Inc. posted its eighth consecutive year of record revenues, earnings and earnings per share. During the year, the company opened 35 new restaurant-entertainment centers (including the acquisition of three new restaurants from franchisees), completed 89 remodels, store expansions and game rotations, and repurchased $82.6 million in outstanding shares of common stock representing 8.5% of fully diluted shares outstanding. These strategies are key components of the company's growth strategy and continue to drive long-term shareholder value.

(Thousands, except per share and store data)	2003	2002	2001
Operating Results			
Revenues	$654,598	$602,201	$562,227
Income before taxes	115,677	113,660	105,204
Net income	70,795	69,526	64,175
Earnings Per Share			
Basic	$2.67	$2.50	$2.30
Diluted	$2.62	$2.46	$2.24
Other Information			
Total assets	$580,351	$539,703	$459,485
Long-term obligations (including current portion)	73,249	69,791	59,285
Shareholders' equity	392,499	384,668	337,236
Change in Comparable Store Sales			
Chuck E. Cheese's	(0.3%)	(1.0%)	2.6%
Number of Restaurants at Year End			
Company operated	418	384	350
Franchise	48	50	52
	466	434	402

After all, we are the business behind the fun.

» No one knows fun better than CEC Entertainment, Inc. But maintaining our industry leadership position is hardly child's play. On average, every week at 466 Chuck E. Cheese's® restaurants around North America, we host 1.3 million guests, serve an average of 260,000 pizzas, celebrate 4,200 birthdays and ensure that every guest leaves happy. Since the company went public in 1989, happy guests have been the driving force behind annualized compounded earnings growth of 32.7 percent and a share price increase of 28.3 percent. The long-term value we offer shareholders is serious business: $10,000 invested in 1989 was worth $419,000 as of 12/28/03 — likewise proving that serious business can also be fun.

Serving up quality is how the game is played.

Transforming Chuck E. Cheese's® from a fledgling enterprise to a $654.6 million revenue business is a story about quality and character – literally. Part restaurant, part entertainment, the business was on the brink of bankruptcy in 1985 when its parent, Brock Hotel Corporation, looked to the outside for help. The hotelier approached Richard Frank, then chief operating officer of Steak & Ale.

While mulling over the offer, Frank made it a point to visit the restaurants wherever he traveled. What he saw wasn't the wholesome family experience that was advertised. The stores were dull, dimly lit and filled with mostly teenagers playing noisy video games. The food wasn't very good either.

But, when the curtain rose above the stage at the rear of the restaurant, an amazing thing happened. The younger kids were completely mesmerized by a life-sized, fur-covered robot. For those few short minutes, the place turned magical. Frank was spellbound by the potential.

He took the job.

"Despite a loss of $62 million in 1985, the business was generating over a hundred million in revenues annually. That's a lot of business for a concept that was supposedly near-dead." Frank says. "There had to be something to it."

He had only to look at the business through a child's eyes to see that the "something" was the appeal of Chuck E. Cheese. His first priority was to shift the focus from teenagers to kids under 12. His next was to hire Richard Huston, a seasoned marketing executive, to get the message to the marketplace. Frank and company then set about improving every aspect of the guest experience, from the food and entertainment to the atmosphere and staff.

It worked. By the spring of 1986, comparable sales had turned positive. By the time Michael Magusiak joined the management team as Vice President and Controller in the summer of 1987, comparable sales were up 5 percent and the company was opening new locations. In 1987 the company generated $5 million in profits.

Since going public, having two brand consolidations and 400 new locations, CEC Entertainment, Inc.'s 15-year annual compounded earnings growth stands at an impressive 32.7 percent.

It's one of the greatest turnarounds in the history of the American restaurant industry – one that says a lot about quality and character, particularly that of a disciplined management team and a timeless mascot named Chuck E. Cheese.





Variety and value are the name of the game.

As any parent who has raised a child in the last quarter century can attest, the Chuck E. Cheese's experience is unlike any other. "The combination of a meal occasion with family play time is what differentiates our concept and contributes to frequency," says Mike Magusiak, CEC Entertainment's president.

Frequency is one of the keys to success in the restaurant/entertainment business. When you look at the statistics, it becomes clear why building guest frequency is one of the fundamental areas of focus for CEC Entertainment.

According to the 2000 U.S. Census, there are 40 million kids under the age of 10. Last year, Chuck E. Cheese's restaurants recorded 42 million kid visits.

"Frequency is important to growing the business, especially because our target market is such a well-defined niche," Magusiak continues. "What's important to these families, at least in terms of discretionary spending, is variety and value."

Chuck E. Cheese's offers both. Variety is evident in the sheer number of games, rides and attractions, which number over 100 in the largest restaurants. Select games and rides are rotated every 18 months to three years. Designed to appeal to various age groups and skill levels, the wide range of entertainment choices ensures that there is something for everyone. It also promises an ever-changing selection of attractions to explore on subsequent visits as young guests grow and mature. Variety also applies to the menu. What started as a pizza-only menu has evolved to include a fresh salad bar, grilled sandwiches, buffalo wings, Italian subs and desserts.

Arguably, the greatest strength of the concept is the value it offers. A package-priced meal and token value deal allows a family of four to enjoy a hot meal, play dozens of games, frolic in free attractions like Skytubes®, meet Chuck E. Cheese in person, take in a live stage show, then head to the winner's counter to exchange prize tickets for souvenirs. Compared with other family entertainment options, Chuck E. Cheese's provides unequalled value that makes the experience accessible for most families and a rite of passage for America's children.


TODDLER ZONE
Chuck E. Cheese's
COLORING BOOK
Chuck E. Cheese's

Concept evolution ensures that we're playing to win.

CEC Entertainment is endowed with a legacy of innovation that began in 1977 with a man named Nolan Bushnell. Bushnell was not only a self-described big kid, he was also a gaming genius. He founded Atari Corporation and invented Pong, one of the first-ever successful video games. He also developed animatronics – the "species" of Chuck E. Cheese and his Pizza Time Players.

Chuck E. Cheese's Pizza Time Theater was Bushnell's highly creative venture that showcased his robotic animals and love of video games. A series of setbacks sent the restaurants into bankruptcy, but animatronic Chuck E. Cheese survived. So did the notion that frequent updates to the stage show and game package would keep the customers coming back.

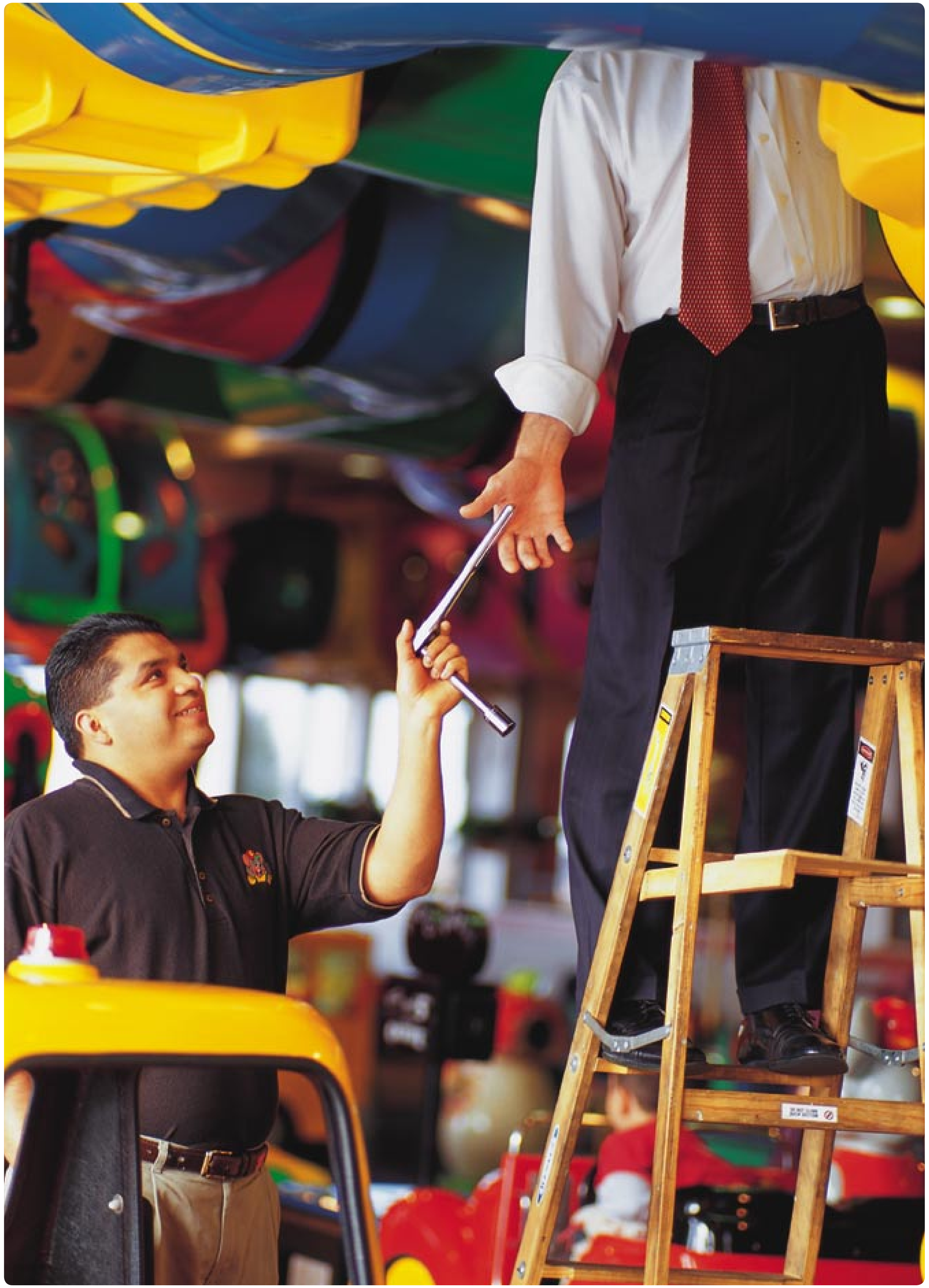
"Today's business model goes beyond updating only the entertainment to evolving the entire concept," says Dick Huston, CEC Entertainment's executive VP of marketing. "Growing the business by keeping the brand evergreen is part of our day-to-day strategy and drives every decision we make."

The first major evolution of the concept began in 1995. Known as Phase I, it was a major repositioning that rebuilt the company's leadership position after three years of brutal competition had eroded the company's sales and market share. Phase I added several lasting brand innovations to the Chuck E. Cheese's experience, including KidCheck® and free Skytubes. Phase I prompted double digit same-store sales increases.

The success of Phase I helped provide the capital and confidence for an even wider set of improvements in 1988-1999. A new initiative named Phase II increased the number of games and rides and enhanced key customer touch points such as the order and prize redemption areas.

Phase III followed in 2000-2003. It focused on enhanced games and rides, an all new Toddler Zone and Skytube improvements. During this period, the company continued to develop new company stores at a 10% growth rate including a smaller square-footage version which has brought Chuck E. Cheese to kids in smaller cities.

"The ongoing evolution of Chuck E. Cheese's has served our guests and shareholders well," notes Huston. Indeed. Since Phase I in 1995-97, the company has posted eight consecutive years of record revenues. Share price has multiplied nearly four fold. Earnings have steadily increased from $0.47 in 1996 to $2.62 per share in 2003. And CEC remains at the top of its game.





We have one performance standard: every guest leaves happy.

Most companies measure customer satisfaction in percentages. CEC Entertainment has a higher standard: every guest leaves happy.

That's no small feat. On any given weekend day, Chuck E. Cheese's employees are charged with the complete satisfaction of more than 250,000 guests in a period of 12 hours.

The company's field management team is more than up to the task. Most if not all have made a career of keeping the company's guests satisfied. Case in point: over 95% of the company's 400+ general managers has been promoted from within. That record of service excellence continues up the corporate ladder. The company's 60 top level field managers: regional managers, district managers and area directors have an average combined tenure of 13.3 years. All were promoted to their current positions. At corporate headquarters in Irving, Texas, the executive management team now averages 17.3 years of service.

The continuity is important. "Certainly it breeds competence and confidence at every level of the company," says Dick Frank, CEC Entertainment's Chairman and CEO, who will mark 19 years with the company in May 2004. "More importantly, it ensures precise execution of the concept and a positive experience for guests."

Guests who leave happy are likely to return, generating improved revenues and greater business opportunities. In a word, growth.

Reinvesting in the concept is a key component of the company's long-term growth strategy. As Frank observes, "You can tell a lot about a company by what it does with its money."

Since going public in 1989, CEC Entertainment has reinvested more than $855 million into the business. These funds were generated from revenues that have grown annually at a compounded rate of 10.1 percent since 1989. The cash not only funded three rounds of major concept evolution and new unit development that averages about 10 percent per year since 1997, but also allowed stock buybacks that represented 8 percent of total shares outstanding in 2003 alone. All of these components of the company's growth strategy for the last 15 years were undertaken while incurring little or no new debt.

It's a testament to the strength and viability of the Chuck E. Cheese's concept and the vision and discipline of the management team who tend to it daily. Together, this winning strategy ensures not only that every guest leaves happy, but also that shareholders remain satisfied and optimistic as well.



Richard M. Frank

CHAIRMAN, CHIEF EXECUTIVE OFFICER



Michael H. Magusiak

PRESIDENT

» TO OUR SHAREHOLDERS

» The biggest news of 2003 was the continued financial health of the company, which has never been better. While posting an eighth consecutive year of record revenues and profitability and achieving additional gains in operational excellence, CEC Entertainment, Inc. generated the strongest operating cash flow of its 26-year history. We took the opportunity to continue the strategic initiatives that have proven successful in building long-term value for shareholders.

With $153 million of operating cash flow, we repurchased $82.6 million of company stock, which represented eight percent of the company's outstanding shares. We also funded capital expenditures of $88.4 million. We used this cash to open 35 new units, including the acquisition of three franchise locations, and completed remodels and implemented game rotations or expansions in 89 existing restaurant centers while increasing debt by only $2 million. These remodels marked the completion of our Phase III capital improvements system-wide. At year end, our debt levels stood at $65 million with a debt to equity ratio of 0.17. It is an enviable position for a company of our size, a testament to both the viability of our concept and the advantage of a disciplined approach to growing the business.

For the year ended December 28, 2003, revenues increased 8.7 percent to $654.6 million from $602.2 million in 2002. Net income improved to $70.8 million from $69.5 million in the previous year. Earnings per share grew to $2.62, up 6.5 percent from $2.46 a year ago. Comparable store sales slipped 0.3 percent in 2003 compared with 2002.

Financial results were negatively impacted by a one-time charge of $4.25 million in the third quarter related to the settlement of a class action wage and hour lawsuit filed in California in 2000. While we believe strongly in our position and deny any liability in this case, we also felt it was in the best interests of the company to settle the matter, thereby resolving all claims and avoiding costly protracted litigation. The net effect of the third-quarter charge was approximately $0.10 per diluted share on an after-tax basis.

Central to our expanded value programs is the "More Fun" sales initiative, which was advertised heavily on television in the third quarter. The key feature of the initiative is that games and rides require only one token. We also increased the number of tickets that guests win, and significantly increased the variety of prizes available in the lower-level categories. The program is a huge success with both children and parents.

We have also enhanced other aspects of our value proposition. New value packages that combine meals, drinks and tokens have been added and several new food items have been introduced. More are in testing. The net result is more fun, more value and more variety, which further distinguishes our concept as the best combined food and entertainment value in the marketplace. We plan to reintroduce the more fun campaign in the first quarter of 2004 and believe it will serve as a cornerstone of our value initiatives for the year.

Even more guests around the country will soon have an opportunity to experience our unique brand of fun and the value it offers. New store development is an essential component of our strategy to grow long-term revenues and earnings, providing a good return on investment and affording us efficiencies with national advertising and overhead. Our growth plans for 2004 include a 10-percent increase in the number of Chuck E. Cheese's locations through new unit development or acquisition. We anticipate 36-40 new units coming on line in 2004. We will also continue to reinvest in existing units as necessary in 2004 to update interiors, rotate or upgrade rides and games, and implement value and menu enhancements.

A continuing highlight of our new unit development is the performance of our "smaller unit" prototype. Strong results in the first nine markets has caused us to modify the model. We are building new units slightly larger and installing a stage show, while still targeting an excellent return on investment.

Like the smaller unit initiative, we believe that the marketplace offers significant growth opportunity, and we are eager to explore it. We have identified approximately 300 additional specific market areas as potential Chuck E Cheese's locations.

It is a prospect for which we have the resources, the people, and the desire to achieve, and one that we believe will continue to offer shareholders an exceptional return on their investment.

WE LOOK FORWARD TO SHARING OUR PROGRESS WITH YOU AND THANK YOU FOR YOUR CONTINUED SUPPORT.

» BOARD OF DIRECTORS



» The strength of CEC Entertainment, Inc.'s business model and the vitality of its Chuck E. Cheese's concept allowed the company to post positive financial performance despite a weak economic climate. While attaining record levels of revenue and earnings, the company opened 35 new Chuck E. Cheese's restaurants (including the acquisition of three franchised locations) and completed remodels and implemented game rotations and expansions in 89 restaurants to close-out the Phase III capital improvement initiative. The company also re-purchased $82.6 million in outstanding common stock, which represents 8 percent of the share's outstanding. The company's solid cash position and low debt-to-capital ratios underscore its strong financial health. This will allow the company to continue its three-pronged approach to driving shareholder value over the long term: increase sales and profits from the existing base; increase market presence through new unit development of approximately 10 percent per year; and continue to repurchase shares as the opportunity arises.

(Thousands, except per share and store data)	2003	2002	2001	2000	1999
Operating results [1]:					
Revenues	$ 654,598	$ 602,201	$ 562,227	$ 506,111	$ 440,904
Costs and expenses	538,921	488,541	457,023	415,377	368,578
Income before income taxes	115,677	113,660	105,204	90,734	72,326
Income taxes	44,882	44,134	41,029	35,379	27,954
Net income	$ 70,795	$ 69,526	$ 64,175	$ 55,355	$ 44,372
Per share [2][3]:					
Basic:					
Net income	$ 2.67	$ 2.50	$ 2.30	$ 2.04	$ 1.63
Weighted average shares outstanding	26,436	27,674	27,816	26,999	27,004
Diluted:					
Net income	$ 2.62	$ 2.46	$ 2.24	$ 1.98	$ 1.58
Weighted average shares outstanding	26,926	28,175	28,514	27,839	27,922
Cash flow data:					
Cash provided by operations	$ 152,842	$ 133,344	$ 119,497	$ 94,085	$ 78,528
Cash used in investing activities	(88,713)	(109,860)	(108,807)	(85,933)	(100,344)
Cash provided by (used in) financing activities	(68,276)	(14,952)	(14,308)	(3,583)	21,337
Balance sheet data:					
Total assets	$ 580,351	$ 539,703	$ 459,485	$ 389,375	$ 325,168
Long-term obligations (including current portion and redeemable preferred stock)	73,249	69,791	59,285	57,288	63,369
Shareholders' equity	392,499	384,668	337,236	282,272	221,228
Number of restaurants at year end:					
Company operated	418	384	350	324	294
Franchise	48	50	52	55	55
	466	434	402	379	349

(1) All fiscal years presented were 52 weeks in length.

(2) No cash dividends on common stock were paid in any of the years presented.

(3) Share and per share information does not reflect the effects of a 3 for 2 stock split effected in the form of a special stock dividend that is effective and distributable on March 15, 2004, to holders of record as of February 25, 2004 (Note 11).

	REVENUES	INCOME BEFORE INCOME TAXES	NET INCOME	EARNINGS PER SHARE BASIC	EARNINGS PER SHARE DILUTED	STOCK MARKET DATA HIGH	STOCK MARKET DATA LOW
2003							
1st Quarter	$ 184,126	$ 44,782	$ 27,407	$ 1.00	$ 1.00	$ 31.66	$ 24.05
2nd Quarter	152,885	24,120	14,761	.54	.54	37.45	26.10
3rd Quarter	170,138	27,516	16,840	.65	.64	40.76	34.24
4th Quarter	147,449	19,259	11,787	.46	.45	52.01	38.99
	$ 654,598	$ 115,677	$ 70,795	$ 2.67	$ 2.62		
2002							
1st Quarter	$ 172,793	$ 43,854	$ 26,796	$ .96	$ .94	$ 49.95	$ 41.83
2nd Quarter	142,416	25,080	15,323	.55	.54	49.37	40.00
3rd Quarter	148,921	27,071	16,539	.60	.59	42.43	32.90
4th Quarter	138,071	17,655	10,868	.39	.39	35.80	23.90
	$602,201	$ 113,660	$ 69,526	$ 2.50	$ 2.46		

Results of Operations

A summary of the results of operations of the Company as a percentage of revenues for the last three fiscal years is shown below.

	2003	2002	2001
Revenues	100.0%	100.0%	100.0%
Costs and expenses:			
Cost of sales	44.3%	44.2%	44.5%
Selling, general and administrative	12.9%	12.7%	13.4%
Depreciation and amortization	6.9%	6.5%	6.1%
Interest expense	.2%	.2%	.4%
Other operating expenses	18.0%	17.5%	16.9%
	82.3%	81.1%	81.3%
Income before income taxes	17.7%	18.9%	18.7%

2003 Compared to 2002

REVENUES » Revenues increased 8.7% to $654.6 million in 2003 from $602.2 million in 2002 primarily due to an increase in the number of Company-operated restaurants. The Company opened 32 new restaurants, acquired three restaurants from franchisees and closed one restaurant in 2003. Comparable store sales decreased 0.3%. Average annual revenues per restaurant declined to approximately $1,628,000 in 2003 from approximately $1,641,000 in 2002. Menu prices increased 0.8% between the two years.

Revenues from franchise fees and royalties were $3.3 million in 2003 compared to $3.2 million in 2002. During 2003, two new franchise restaurants opened, three franchise restaurants were acquired by the Company and one franchise restaurant closed. Franchise comparable store sales increased 1.4% in 2003.

COSTS AND EXPENSES » Costs and expenses as a percentage of revenues increased to 82.3% in 2003 from 81.1% in 2002.

Cost of sales as a percentage of revenues increased to 44.3% in 2003 from 44.2% in 2002. Costs of food, beverage, and related supplies as a percentage of revenues were 12.2% in both 2003 and 2002. Costs of games and merchandise increased to 4.3% in 2003 from 4.2% in 2002 primarily due to higher prize costs resulting from a guest value program implemented in the second quarter of 2003. Restaurant labor expenses as a percentage of revenues remained constant at 27.8% in both 2003 and 2002.

Selling, general and administrative expenses as a percentage of revenues increased to 12.9% in 2003 from 12.7% in 2002 primarily due to a $4.25 million charge in 2003 relating to the settlement, subject to court approval, of a class action wage and hour lawsuit filed in the State of California. In January 2004, the court granted preliminary approval of this settlement.

Depreciation and amortization expense as a percentage of revenues increased to 6.9% in 2003 from 6.5% in 2002 primarily due to capital invested in new restaurants and remodels.

Interest expense as a percentage of revenues was 0.2% in both 2003 and 2002.

Other operating expenses increased as a percentage of revenues to 18.0% in 2003 from 17.5% in 2002 primarily due to losses on the disposal of assets, repairs and property taxes.

The Company's effective income tax rate was 38.8% in both 2003 and 2002.

NET INCOME » The Company had net income of $70.8 million in 2003 compared to $69.5 million in 2002 due to the changes in revenues and expenses discussed above. The Company's diluted earnings per share increased 6.5% to $2.62 per share in 2003 compared to $2.46 per share in 2002 due to the 1.9% increase in net income discussed above and a 4.6% decrease in the Company's number of weighted average shares outstanding. Weighted average diluted shares outstanding decreased to 26.9 million in 2003 from 28.2 million in 2002 primarily due to the Company's share repurchase program.

2002 Compared to 2001

REVENUES » Revenues increased 7.1% to $602.2 million in 2002 from $562.2 million in 2001 due to new restaurants. The Company opened 32 new restaurants, acquired three restaurants from franchisees and closed one restaurant in 2002. Comparable store sales decreased 1.0%. The Company completed Phase III upgrades

in 105 restaurants in 2001 and 123 restaurants in 2002. Average annual revenues per restaurant increased to approximately $1,641,000 in 2002 from approximately $1,634,000 in 2001. Menu prices increased 0.4% between the two years.

Revenues from franchise fees and royalties were $3.2 million in both 2002 and 2001. One new franchise restaurant opened and three franchise restaurants were acquired by the Company during 2002. Franchise comparable store sales decreased 0.4% in 2002.

COSTS AND EXPENSES » Costs and expenses as a percentage of revenues decreased to 81.1% in 2002 from 81.3% in 2001.

Cost of sales as a percentage of revenues decreased to 44.2% in 2002 from 44.5% in 2001. Costs of food, beverage, and related supplies as a percentage of revenues decreased to 12.2% in 2002 from 12.8% in 2001 primarily due to lower cheese costs. Costs of games and merchandise decreased to 4.2% in 2002 from 4.4% in 2001 due to buying efficiencies. Restaurant labor expenses as a percentage of revenues increased to 27.8% in 2002 from 27.3% in 2001 primarily due to the decrease in comparable store sales and higher average wage rates.

Selling, general and administrative expenses as a percentage of revenues declined to 12.7% in 2002 from 13.4% in 2001 primarily due to scale efficiencies in advertising expense and corporate overhead costs.

Depreciation and amortization expense as a percentage of revenues increased to 6.5% in 2002 from 6.1% in 2001 primarily due to increased capital expenditures and the decrease in comparable store sales.

Interest expense as a percentage of revenues was 0.2% in 2002 compared to 0.4% in 2001 primarily due to a reduction in interest rates.

Other operating expenses increased as a percentage of revenues to 17.5% in 2002 from 16.9% in 2001 primarily due to higher insurance costs. Insurance expense increased approximately $5.3 million in 2002 compared to 2001 due to several factors including higher premiums, claim loss experience and medical costs.

The Company's effective income tax rate was 38.8% in 2002 and 39.0% in 2001 due to lower estimated state tax rates.

NET INCOME » The Company had net income of $69.5 million in 2002 compared to $64.2 million in 2001 due to the changes in revenues and expenses discussed above. The Company's diluted earnings per share increased to $2.46 per share in 2002 compared to $2.24 per share in 2001.

Significant Accounting Policies and Estimates

In preparing the Company's financial statements, management is required to make ongoing estimates and judgments based on the information available. Management believes the following critical accounting policies require the most significant estimates and judgments.

The Company estimates its liability for incurred but unsettled general liability and workers compensation related claims under its self-insured retention programs, including reported losses in the process of settlement and losses incurred but not reported. The estimate is based on loss development factors determined through actuarial methods using the actual claim loss experience of the Company subject to adjustment for current trends. Revisions to the estimated liability resulting from ongoing periodic reviews are recognized in the period in which the differences are identified. Significant increases in general liability and workers compensation claims could have a material adverse impact on future operating results.

The Company periodically reviews the estimated useful lives and recoverability of its depreciable assets based on factors including historical experience, the expected beneficial service period of the asset, the quality and durability of the asset and the Company's maintenance policy including periodic upgrades. Changes in useful lives are made on a prospective basis, unless factors indicate the carrying amounts of the assets may not be recoverable from estimated future cash flows and an impairment write-down is necessary.

Inflation

The Company's cost of operations, including but not limited to labor, supplies, utilities, financing and rental costs, are significantly affected by inflationary factors. The Company pays most of its part-time employees rates that are related to federal and state mandated minimum wage requirements. Management anticipates that any increases in federally mandated minimum wage would result in higher costs to the Company, which the Company expects would be partially offset by menu price increases and increased efficiencies in operations.

MANAGEMENT'S DISCUSSION & ANALYSIS

Financial Condition, Liquidity and Capital Resources

Cash provided by operations increased to $152.8 million in 2003 from $133.3 million in 2002. Cash outflows from investing activities for 2003 were $88.7 million, primarily related to capital expenditures. Cash outflows from financing activities for 2003 were $68.3 million, primarily related to the repurchase of the Company's common stock. The Company's primary requirements for cash relate to planned capital expenditures, the repurchase of the Company's common stock and debt service. The Company expects that it will satisfy such requirements from cash provided by operations and, if necessary, funds available under its line of credit.

The Company has initiated several strategies to increase revenues and earnings over the long-term that require capital expenditures. These strategies include: a) new restaurant development and acquisitions of existing restaurants from franchisees; b) a game rotation plan; c) major remodels or reconfigurations, and; d) expansions of the retail area of existing restaurants. In addition, the Company is currently testing revisions to the building exterior along with interior enhancements in conjunction with a game rotation.

The game rotation plan began in 2003 and has an average capital cost of approximately $60,000 per store. The primary components of this plan are to provide new and transferred games and rides and in certain stores, enhancements to the toddler area. The major remodel or reconfiguration initiative includes a reallocation of space between the dining and game room areas, expansion of the space allocated to the game room and an increase in the number of games. The typical capital cost of this initiative will range from $225,000 to $400,000 per store. Expansion of the retail areas may vary widely based on square footage and can range in cost from $200,000 to $900,000 per store but generally have an average capital cost of approximately $500,000.

During 2003, the Company opened 32 new restaurants, acquired three restaurants from franchisees, completed the game rotation plan in 33 restaurants, completed three reconfigurations and three expansions. In 2003, the Company also completed its Phase III upgrade program with upgrades in 50 restaurants. The average cost of a Phase III upgrade was approximately $205,000 to $215,000 per store. A Phase III upgrade generally included a new toddler area, skill games and rides, kiddie games and rides, SkyTube enhancements, prize area improvements and Kid Check modifications.

In 2004, the Company plans to add 36 to 40 stores including new restaurants and acquisitions of existing restaurants from franchisees. The Company currently anticipates its cost of opening such new restaurants will vary depending upon many factors including the size of the restaurants, the amount of any landlord contribution and whether the Company acquires land or the store is an in-line or freestanding building. The average

capital cost of all new restaurants expected to open in 2004 is approximately $1.4 million per restaurant. At the beginning of 2004, the Company identified development opportunities for approximately 300 restaurants including those restaurants expected to open in 2004.

In 2004, the Company plans to complete game rotations in 60 to 80 restaurants. The Company plans to complete a major remodel or reconfiguration in a select number of restaurants that are believed to have the greatest opportunity to significantly increase sales and provide an adequate return on investment. The Company has currently identified 10 to 20 potential locations for a major remodel including the three franchise locations acquired in 2003. The Company also plans to expand the square footage of approximately four to five restaurants. In addition, the Company is currently testing revisions to the building exterior along with interior enhancements in conjunction with a game rotation. The Company expects the aggregate capital costs of completing game rotations, major remodels and reconfigurations and expansions in 2004 to total approximately $16 million and impact 105 to 110 restaurants.

The Company currently estimates that capital expenditures in 2004 will be $79 million to $85 million. The Company plans to finance these expenditures through cash flow from operations and, if necessary, borrowings under the Company's line of credit.

From time to time, the Company repurchases shares of its common stock under a plan authorized by its Board of Directors. The plan authorizes repurchases in the open market or in private transactions. In 2003, the Company repurchased 2,285,776 shares of its common stock at an aggregate price of approximately $82.6 million. Beginning in 1993 through 2003, the Company has repurchased approximately 10.1 million shares of the Company's common stock at an aggregate purchase price of approximately $207 million. In 2004, the Company completed a plan authorized in 2003 and announced a new plan to repurchase shares of the Company's common stock at an aggregate purchase price of up to $75 million. In 2003, the Company reacquired all of its outstanding preferred stock for approximately $2.8 million.

In 2002, the Company entered into a new line of credit agreement that provides borrowings of up to $100 million and matures in 2005. In 2003, available borrowings under the line of credit agreement increased to $132.5 million. Interest under the line of credit is dependent on earnings and debt levels of the Company and ranges from prime or, at the Company's option, LIBOR plus 0.75% to 1.50%. Currently, any borrowings under this line of credit would be at the prime rate or LIBOR plus 0.75%. As of December 28, 2003, there were $64.4 million in borrowings under this line of credit. In addition, the Company had outstanding letters of credit of

$3.5 million at December 28, 2003. The Company is required to comply with certain financial ratio tests during the terms of the loan agreement.

The following are contractual cash obligations of the Company as of December 28, 2003:

(Thousands) CASH OBLIGATIONS DUE BY YEAR

	Total	2004	2005	2006	2007	Thereafter
Operating leases	$ 355,507	$ 53,982	$ 52,729	$ 49,479	$ 43,524	$ 155,793
Revolving line of credit	64,400		64,400			
Purchase commitments	36,945	4,820	4,966	5,116	5,272	16,771
Capital lease obligations	410	214	196			
	$ 457,262	$ 59,016	$ 122,291	$ 54,595	$ 48,796	$ 172,564

In addition to the above, the Company estimates that the accrued liabilities for group medical, general liability and workers compensation claims of approximately $16.4 million as of December 28, 2003 will be paid as follows: approximately $7.9 million to be paid in 2004 and the remainder paid over the six year period from 2005 to 2010.

Certain statements in this report, other than historical information, may be considered forward-looking statements within the meaning of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, and are subject to various risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may differ from those anticipated, estimated or expected. Among the key factors that may have a direct bearing on the Company's operating results, performance or financial condition are its ability to implement its growth strategies, national, regional and local economic conditions affecting the restaurant/entertainment industry, competition within each of the restaurant and entertainment industries, store sales cannibalization, success of its franchise operations, negative publicity, fluctuations in quarterly results of operations, including seasonality, government regulations, weather, school holidays, commodity, insurance and labor costs.

Quantitative and Qualitative Disclosures About Market Risk

The Company is subject to market risk in the form of interest rate risk and foreign currency risk. Both interest rate risk and foreign currency risk are immaterial to the Company.

BOARD OF DIRECTORS AND SHAREHOLDERS

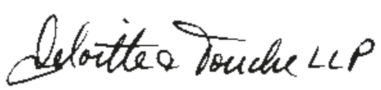
CEC ENTERTAINMENT, INC.

IRVING, TEXAS

We have audited the accompanying consolidated balance sheets of CEC Entertainment, Inc. and subsidiaries as of December 28, 2003 and December 29, 2002, and the related consolidated statements of earnings and comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 28, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of CEC Entertainment, Inc. and subsidiaries as of December 28, 2003 and December 29, 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 28, 2003, in conformity with accounting principles generally accepted in the United States of America.



DELOITTE & TOUCHE LLP

Dallas, Texas

March 8, 2004

(Thousands, except share data)	DECEMBER 28, 2003	DECEMBER 29, 2002
Assets		
Current assets:		
Cash and cash equivalents	$ 8,067	$ 12,214
Accounts receivable, net	13,103	11,270
Inventories	12,491	10,716
Prepaid expenses	7,608	5,500
Deferred tax asset	1,487	1,319
Total current assets	42,756	41,019
Property and equipment, net	536,124	493,533
Other assets:		
Notes receivable from related party		3,825
Other	1,471	1,326
	1,471	5,151
	$ 580,351	$ 539,703
Liabilities And Shareholders' Equity		
Current liabilities:		
Current portion of long-term debt	$ 168	$ 143
Accounts payable and accrued liabilities	58,736	43,002
Total current liabilities	58,904	43,145
Long-term debt, less current portion	64,581	62,349
Deferred rent	5,153	4,086
Deferred tax liability	50,714	38,156
Accrued insurance	8,500	4,750
Commitments and contingencies (Note 7)		
Redeemable preferred stock		2,549
Shareholders' equity:		
Common stock, $.10 par value; authorized 100,000,000 shares; 36,321,275 and 35,669,773 shares issued, respectively	3,632	3,567
Capital in excess of par value	220,887	201,936
Retained earnings	378,911	308,277
Accumulated other comprehensive income (loss)	695	(91)
Less treasury shares of 10,694,945 and 8,409,169, respectively, at cost	(211,626)	(129,021)
	392,499	384,668
	$ 580,351	$ 539,703

See notes to consolidated financial statements.

(Thousands, except per share data)

	FISCAL YEAR 2003	2002	2001
Food and beverage revenues	$ 433,952	$ 400,119	$ 380,014
Games and merchandise revenues	217,261	198,466	178,766
Franchise fees and royalties	3,335	3,188	3,173
Interest income, including related party income of $404 and $181 in 2002 and 2001, respectively	50	428	274
	654,598	602,201	562,227
Costs and expenses:			
Cost of sales	290,005	266,357	250,138
Selling, general and administrative expenses	84,701	76,621	75,275
Depreciation and amortization	45,109	39,243	34,397
Interest expense	1,449	1,201	2,036
Other operating expenses	117,657	105,119	95,177
	538,921	488,541	457,023
Income before income taxes	115,677	113,660	105,204
Income taxes	44,882	44,134	41,029
Net income	70,795	69,526	64,175
Other comprehensive income (loss), net of tax:			
Foreign currency translation	786	87	(148)
Comprehensive income	$ 71,581	$ 69,613	$ 64,027
Earnings per share:			
Basic:			
Net income	$ 2.67	$ 2.50	$ 2.30
Weighted average shares outstanding	26,436	27,674	27,816
Diluted:			
Net income	$ 2.62	$ 2.46	$ 2.24
Weighted average shares outstanding	26,926	28,175	28,514

See notes to consolidated financial statements.

(Thousands, except per share data)

	FISCAL YEAR - AMOUNTS 2003	2002	2001	FISCAL YEAR-SHARES 2003	2002	2001
Common stock and capital in excess of par value:						
Balance, beginning of year	$ 205,503	$ 195,574	$ 181,287	35,670	35,325	34,585
Stock options exercised	14,588	6,367	10,547	640	338	785
Tax benefit from exercise of stock options	4,072	3,265	4,174			
Stock issued under 401(k) plan	356	297	176	11	7	5
Treasury stock retired and reserved for 401(k) plan			(610)			(50)
Balance, end of year	224,519	205,503	195,574	36,321	35,670	35,325
Retained earnings:						
Balance, beginning of year	308,277	239,070	175,217			
Net income	70,795	69,526	64,175			
Redeemable preferred stock accretion	(49)	(95)	(91)			
Redeemable preferred stock dividend	(112)	(224)	(231)			
Balance, end of year	378,911	308,277	239,070			
Accumulated other comprehensive income (loss):						
Balance, beginning of year	(91)	(178)	(30)			
Foreign currency translation	786	87	(148)			
Balance, end of year	695	(91)	(178)			
Treasury shares:						
Balance, beginning of year	(129,021)	(97,230)	(74,202)	8,409	7,586	7,040
Treasury stock acquired	(82,605)	(31,791)	(23,638)	2,286	823	596
Treasury stock retired and reserved for 401(k) plan			610			(50)
Balance, end of year	(211,626)	(129,021)	(97,230)	10,695	8,409	7,586
Total shareholders' equity	$ 392,499	$384,668	$ 337,236			

See notes to consolidated financial statements.

(Thousands)

	FISCAL YEAR 2003	2002	2001
Operating activities:			
Net income	$ 70,795	$ 69,526	$ 64,175
Adjustments to reconcile net income to cash provided by operations:			
Depreciation and amortization	45,109	39,243	34,397
Deferred income tax expense	12,390	18,246	12,088
Tax benefit from exercise of stock options	4,072	3,265	4,174
Other	2,686	1,333	836
Net change in receivables, inventories, prepaids, payables and accrued liabilities	17,790	1,731	3,827
Cash provided by operations	152,842	133,344	119,497
Investing activities:			
Purchases of property and equipment	(88,386)	(108,126)	(111,202)
Proceeds from dispositions of property and equipment			297
Payments received on notes receivable		2,201	2,677
Additions to notes receivable		(3,971)	(3,206)
Change in other assets	(327)	(426)	647
Sale of assets held for resale		462	1,980
Cash used in investing activities	(88,713)	(109,860)	(108,807)
Financing activities:			
Proceeds from debt and line of credit	48,700	52,375	37,100
Payments on debt and line of credit	(46,443)	(41,946)	(38,169)
Redeemable preferred stock dividends	(112)	(224)	(231)
Acquisition of treasury stock	(82,605)	(31,791)	(23,638)
Exercise of stock options	14,588	6,367	10,547
Redemption of preferred stock	(2,795)		
Other	391	267	83
Cash used in financing activities	(68,276)	(14,952)	(14,308)
Increase (decrease) in cash and cash equivalents	(4,147)	8,532	(3,618)
Cash and cash equivalents, beginning of year	12,214	3,682	7,300
Cash and cash equivalents, end of year	$ 8,067	$ 12,214	$ 3,682

See notes to consolidated financial statements.

1. Summary of significant accounting policies

OPERATIONS » CEC Entertainment, Inc. and its subsidiaries (the "Company") operates and franchises family restaurant/entertainment centers as Chuck E. Cheese's restaurants.

FISCAL YEAR » The Company's fiscal year is 52 or 53 weeks and ends on the Sunday nearest December 31. References to 2003, 2002 and 2001 are for the fiscal years ended December 28, 2003, December 29, 2002, and December 30, 2001, respectively. Fiscal years 2003, 2002 and 2001 each consisted of 52 weeks.

BASIS OF CONSOLIDATION » The consolidated financial statements include the accounts of the Company and its subsidiaries. In 2003, the Company adopted the Financial Accounting Standards Board's Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46). Accordingly, at the beginning of 2003, the Company consolidated the financial statements of the International Association of CEC Entertainment, Inc. (the "Association"), a related party. The consolidation did not have a material impact on the Company's consolidated results of operations, financial position or cash flows. Notes receivable from the Association, previously reported in prior periods, are currently eliminated in this consolidation and replaced with the Association's assets, which are primarily prepaid advertising costs and cash. All significant intercompany accounts and transactions have been eliminated.

FOREIGN CURRENCY TRANSLATION » The consolidated financial statements are presented in U.S. dollars. The assets and liabilities of the Company's Canadian subsidiary are translated to U.S. dollars at year-end exchange rates, while revenues and expenses are translated at average exchange rates during the year. Adjustments that result from translating amounts are reported as a component of other comprehensive income.

CASH AND CASH EQUIVALENTS » Cash and cash equivalents of the Company are composed of demand deposits with banks and short-term cash investments with remaining maturities of three months or less from the date of purchase by the Company.

INVENTORIES » Inventories of food, paper products, merchandise and supplies are stated at the lower of cost on a first-in, first-out basis or market.

PROPERTY AND EQUIPMENT, DEPRECIATION AND AMORTIZATION » Property and equipment are stated at cost, net of accumulated depreciation and amortization. Depreciation and amortization are provided by charges to operations over the estimated useful lives of the assets by the straight-line method, generally ranging from four to 20 years for furniture, fixtures and equipment and 40 years for buildings. Leasehold improvements are amortized over the shorter of their estimated useful lives or the related lease life, generally ranging from 10 to 20 years. All pre-opening costs are expensed as incurred.

The Company evaluates long-lived assets held and used in the business for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Long-lived assets are grouped at the lowest level for which identifiable cash flows are largely independent. The carrying amount of long-lived assets is not recoverable if it exceeds the sum of associated undiscounted future cash flows. The amount of any impairment is measured as the excess of the carrying amount over associated discounted future operating cash flows. Assets held for sale are reported at the lower of carrying amount or the fair value less costs to sell.

FAIR VALUE OF FINANCIAL INSTRUMENTS » The Company has certain financial instruments consisting primarily of cash equivalents, notes receivable and notes payable. The carrying amount of cash equivalents approximates fair value because of the short maturity of those instruments. The carrying amount of the Company's notes receivable and long-term debt approximates fair value based on the interest rates charged on instruments with similar terms and risks.

STOCK-BASED COMPENSATION » The Company accounts for its stock based compensation under the intrinsic value method of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations ("APB 25"), and has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock Based Compensation" ("SFAS 123"). Under APB 25, no stock-based compensation cost is reflected in net income for grants of stock options to employees because the Company grants stock options with an exercise price equal to the market value of the stock on the date of grant.

Had compensation cost for the Company's stock option plans been determined based on the fair value method at the grant date for awards under those plans consistent with the method prescribed by SFAS No. 123, the Company's pro forma net income and earnings per share would have been as follows (thousands, except per share data):

	2003	2002	2001
Net income, as reported	$ 70,795	$ 69,526	$ 64,175
Fair value based compensation expense, net of taxes	(6,507)	(6,439)	(4,613)
Pro forma net income	$ 64,288	$ 63,087	$ 59,562
Earnings per Share:			
Basic:			
As reported	$ 2.67	$ 2.50	$ 2.30
Pro forma	$ 2.43	$ 2.26	$ 2.13
Diluted:			
As reported	$ 2.62	$ 2.46	$ 2.24
Pro forma	$ 2.38	$ 2.22	$ 2.08

For the pro forma calculations above, the estimated fair value of options granted was $9.48, $14.69 and $11.91 per share in 2003, 2002 and 2001, respectively. The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants: risk free interest rate of 3.10%, 4.34% and 4.80% in 2003, 2002 and 2001, respectively; no dividend yield; expected lives of five years; and expected volatility of 30%.

FRANCHISE FEES AND ROYALTIES » Franchise fees are recognized upon fulfillment of all significant obligations to the franchisee. At December 28, 2003, 48 Chuck E. Cheese's restaurants were operated by a total of 29 different franchisees. The standard franchise agreements grant to the franchisee the right to construct and operate a restaurant and use the associated trade names, trademarks and service marks within the standards and guidelines established by the Company. Royalties from franchisees are accrued as earned. Franchise fees included in revenues were $281,000, $240,000, and $114,000 in 2003, 2002 and 2001, respectively.

ADVERTISING COSTS » Production costs for commercials are expensed in the year in which the commercials are initially aired. All other advertising costs are expensed as incurred. The total amounts charged to advertising expense were approximately $24.6 million, $24.4 million and $24.0 million in 2003, 2002 and 2001, respectively.

USE OF ESTIMATES AND ASSUMPTIONS » The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

RECLASSIFICATIONS » Certain reclassifications of 2002 and 2001 amounts have been made to conform to the 2003 presentation.

RECENT ACCOUNTING PRONOUNCEMENTS » In December 2003, the Financial Accounting Standards Board issued a revision to Financial Accounting Standards Board Interpretation No. 46 ("FIN 46R"). FIN 46R requires an evaluation of franchise arrangements to determine if franchisees should be consolidated beginning in the first quarter of fiscal 2004. The Company is currently in the process of evaluating FIN 46R but does not believe that its adoption will have a material effect on the Company's financial statements.

2. Accounts receivable

(thousands)	2003	2002
Trade	$ 2,414	$ 2,495
Tax receivables	1,873	3,915
Vendor rebates	3,638	3,108
Construction allowances from landlords	3,481	779
Other	1,697	973
	$ 13,103	$ 11,270

3. Notes receivable from related party

The Company and its franchisees contribute a percentage of revenues ("Assessments") to the Association, a related party, to develop entertainment attractions and produce and communicate system wide advertising. The Association has ten directors, five of whom are also employees of the Company. At December 29, 2002, approximately $3,825,000 was outstanding under notes receivable from the Association. The Company also had accounts payable to the Association of $2,475,000 at December 29, 2002 primarily for December assessments. At the beginning of 2003, the Company adopted FIN 46 and has consolidated the financial statements of the Association. (Note 1). Accordingly, all significant intercompany accounts and transactions have been eliminated in 2003.

4. Property and equipment

(thousands)	2003	2002
Land	$ 40,357	$ 36,329
Leasehold improvements	301,088	263,625
Buildings	49,305	44,186
Game, restaurant and other equipment	328,369	299,251
Property leased under capital leases (Note 7)	449	449
	719,568	643,840
Less accumulated depreciation and amortization	(204,845)	(169,836)
Net property and equipment in service	514,723	474,004
Construction in progress	7,547	7,305
Game and restaurant equipment held for future service	13,854	12,224
	$ 536,124	$ 493,533

5. Accounts payable and accrued insurance

(thousands)	2003	2002
Current:		
Accounts payable	$ 30,126	$ 19,933
Salaries and wages	8,665	7,630
Insurance	7,888	6,896
Taxes, other than income	5,668	5,488
Income taxes	2,804	
Other	3,585	3,055
	$ 58,736	$ 43,002
Long-term:		
Insurance	$ 8,500	$ 4,750

Accrued insurance liabilities represent estimated claims incurred but unpaid under the Company's self-insured retention programs for general liability, workers compensation, health benefits and certain other insured risks.

6. Long-term debt

(thousands)	2003	2002
Revolving bank loan, prime or LIBOR plus 0.75% to 1.5%, due December 2005	$ 64,400	$ 62,000
Obligations under capital leases (Note 7)	349	492
	64,749	62,492
Less current portion	(168)	(143)
	$ 64,581	$ 62,349

In 2002, the Company entered into a line of credit agreement which provides the Company with a revolving credit facility of $100 million and matures in 2005. In 2003, available borrowings under the line of credit agreement increased to $132.5 million. Interest under the line of credit is payable at rates which are dependent on earnings and debt levels of the Company. Currently, any borrowings under this line of credit would be at prime (4.00% at December 28, 2003) or, at the Company's option, LIBOR (1.12% at December 28, 2003) plus 0.75%. A

0.2% commitment fee is payable on any unused credit line. The Company is required to comply with certain financial ratio tests during the terms of the loan agreement. The weighted average interest rate on long-term debt was 2.0% and 3.1% in 2003 and 2002, respectively. The Company capitalized interest costs of $77,000, $176,000 and $306,000 in 2003, 2002 and 2001, respectively.

7. Commitments and contingencies

The Company leases certain restaurants and related property and equipment under operating and capital leases. All leases require the Company to pay property taxes, insurance and maintenance of the leased assets. The leases generally have initial terms of 10 to 20 years with various renewal options.

Scheduled annual maturities of the obligations for capital and operating leases as of December 28, 2003, are as follows:

YEARS (thousands)	CAPITAL	OPERATING
2004	$ 214	$ 53,982
2005	196	52,729
2006		49,479
2007		43,524
2008-2028 (aggregate payments)		155,793
Minimum future lease payments	410	$ 355,507
Less amounts representing interest	(61)	
Present value of future minimum lease payments	349	
Less current portion	(168)	
Long-term capital lease obligation	$ 181	

Deferred rent is provided to recognize the minimum rent expense on a straight-line basis when rental payments are not made on such basis. Certain of the Company's real estate leases require payment of contingent rent based on a percentage of sales. The Company's rent expense is comprised of the following:

(thousands)	2003	2002	2001
Minimum	$ 56,350	$ 51,195	$ 47,884
Contingent	291	330	452
	$ 56,641	$ 51,525	$ 48,336

From time to time the Company is involved in litigation, most of which is incidental to its business. In the Company's opinion, no litigation to which the Company currently is a party is likely to have a material adverse effect on the Company's results of operations, financial condition or cash flows.

In September 2003, the Company recorded a charge to selling, general and administrative expense of $4.25 million related to the settlement agreed to on September 29, 2003, subject to court approval, in a class action wage and hour lawsuit filed in the State of California. In January 2004, the court granted preliminary approval of this settlement.

8. Redeemable preferred stock

In May 2003, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity"("SFAS 150"). SFAS 150 required the Company to classify redeemable preferred stock dividend preferences as interest cost effective at the beginning of the three-month period ended September 28, 2003. After that date in 2003, redeemable preferred stock accretion and dividends of $164,000 is included in interest expense; comparable amounts in prior periods are reported in shareholders' equity. In October 2003, the Company reacquired for approximately $2.8 million all of its outstanding redeemable preferred stock. Also, in 2003 the increase of $163,000 in the carrying value of the redeemable preferred stock to the redemption amount is included in interest expense.

9. Cost of sales

(thousands)	2003	2002	2001
Food, beverage and related supplies	$ 79,982	$ 73,690	$ 72,006
Games and merchandise	28,234	25,490	24,871
Labor	181,789	167,177	153,261
	$ 290,005	$ 266,357	$ 250,138

10. Income taxes

The significant components of income tax expense are as follows:

(thousands)	2003	2002	2001
Current expense:			
Federal	$ 23,430	$ 18,571	$ 20,957
State	4,810	3,854	3,648
Foreign	180	198	162
Tax benefit from exercise of stock options	4,072	3,265	4,174
Total current expense	32,492	25,888	28,941
Deferred expense:			
Federal	11,450	16,199	10,412
State	940	2,047	1,676
Total temporary differences	12,390	18,246	12,088
	$ 44,882	$ 44,134	$ 41,029

Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases. The income tax effects of temporary differences which give rise to deferred income tax assets and liabilities are as follows:

(thousands)	2003	2002
Current deferred tax asset:		
Accrued vacation	$ 894	$ 766
Unearned gift certificates	498	406
Other	95	147
	$ 1,487	$ 1,319
Non-current deferred tax asset (liability):		
Deferred rent	$ 1,994	$ 1,580
Unearned franchise fees	91	92
Depreciation	(53,372)	(39,471)
Foreign	(479)	(335)
Other	1,052	(22)
	$ (50,714)	$ (38,156)

A reconciliation of the statutory rate to taxes provided is as follows:

	2003	2002	2001
Federal statutory rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	3.3%	3.9%	3.9%
Other	.5%	(.1)%	.1%
Effective tax rate	38.8%	38.8%	39.0%

11. Earnings per common share

Basic earnings per common share ("EPS") is computed by dividing earnings applicable to common shares by the weighted average number of common shares outstanding. Diluted EPS adjusts for the effect of potential common shares from dilutive stock options using the treasury stock method. Net income applicable to common shares has been adjusted for redeemable preferred stock accretion and dividends for the applicable periods.

Earnings per common and potential common shares were computed as follows (thousands, except per share data):

	2003	2002	2001
Net income	$ 70,795	$ 69,526	$ 64,175
Accretion of redeemable preferred stock	(49)	(95)	(91)
Redeemable preferred stock dividends	(112)	(224)	(231)
Net income applicable to common shares	$ 70,634	$ 69,207	$ 63,853
Basic:			
Weighted average common shares outstanding	26,436	27,674	27,816
Earnings per common share	$ 2.67	$ 2.50	$ 2.30
Diluted:			
Weighted average common shares outstanding	26,436	27,674	27,816
Potential common shares for stock options	490	501	698
Weighted average shares outstanding	26,926	28,175	28,514
Earnings per common and potential common shares	$ 2.62	$ 2.46	$ 2.24

Antidilutive stock options to purchase 762,096, 787,901 and 6,604 common shares were not included in the EPS computations in 2003, 2002 and 2001, respectively, because the exercise prices of these options were greater than the average market price of the common shares.

On February 18, 2004, the Company announced that its Board of Directors had declared a 3 for 2 stock split effected in the form of a special stock dividend that is effective and distributable on March 15, 2004 to holders of record as of February 25, 2004. The share information included in these financial statements and notes does not reflect the effect of such stock split. Pro forma diluted EPS on a post-split basis would be $1.75, $1.64 and $1.49 in 2003, 2002 and 2001, respectively.

12. Employee benefit plans

The Company has employee benefit plans that include: a) incentive bonus compensation plans based on the performance of the Company; b) non-statutory stock option plans for its employees and non-employee directors, and; c) a retirement and savings plan.

In 1997, the Company adopted an employee stock option plan under which 6,787,500 shares, as amended in 2003, may be granted before July 31, 2007. In 1995, the Company adopted a stock option plan for its non-employee directors. The number of shares of the Company's common stock that may be issued under this plan cannot exceed 225,000 shares. The exercise price for options granted under both plans may not be less than the fair market value of the Company's common stock at date of grant. Options may not be exercised until the employee has been continuously employed at least one year after the date of grant. Options which expire or terminate may be re-granted under the plan. Options which have been granted under the plans cannot be re-priced.

At December 28, 2003, there were 1,846,901 shares available for future grants under the employee and non-employee directors stock option plans. Stock option transactions are summarized as follows for all plans:

	NUMBER OF SHARES			WEIGHTED AVERAGE EXERCISE PRICE PER SHARE		
	2003	2002	2001	2003	2002	2001
Options outstanding, beginning of year	3,025,475	2,650,611	2,488,368	$ 30.63	$ 25.26	$ 17.95
Granted	1,509,837	792,299	989,957	29.97	43.45	34.09
Exercised	(639,907)	(337,656)	(784,669)	22.80	18.86	13.44
Terminated	(163,198)	(79,779)	(43,045)	32.29	29.42	21.27
Options outstanding, end of year	3,732,207	3,025,475	2,650,611	31.63	30.63	25.26

Options outstanding at December 28, 2003:

	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
RANGE OF EXERCISE PRICES	SHARES OUTSTANDING AS OF 12/28/03	WEIGHTED AVG. REMAINING LIFE (YEARS)	WEIGHTED AVERAGE EXERCISE PRICE	SHARES EXERCISABLE AS OF 12/28/03	WEIGHTED AVERAGE EXERCISE PRICE
$13.67 - $19.94	307,972	1.7	$16.55	307,413	$16.55
$22.44 - $24.25	337,240	3.3	23.25	198,601	23.25
$25.00 - $29.99	1,575,637	5.8	29.47	85,376	25.62
$30.06 - $39.80	751,077	4.0	34.01	327,758	34.00
$40.30 - $54.27	760,281	6.1	43.56	15,907	44.12
$13.67 - $54.27	3,732,207	4.7	31.63	935,055	25.39

Stock options expire seven years from the grant date. Stock options vest over various periods ranging from one to four years. In 2004, the Company granted 393,561 additional options to employees at exercise prices of $47.24 to $47.80 per share and 20,000 options to its non-employee directors at an exercise price of $47.83 per share.

The Company has adopted the CEC 401(k) Retirement and Savings Plan, to which it may at its discretion make an annual contribution out of its current or accumulated earnings. Contributions by the Company may be made in the form of its common stock or in cash. At December 28, 2003, 33,300 shares remained available for grant under the plan. The Company made contributions of approximately $356,000 and $297,000 in common stock for the 2002 and 2001 plan years, respectively. The Company accrued $400,000 for contributions for the 2003 plan year which will be paid in common stock in 2004.

13. Supplemental cash flow information

(thousands)	2003	2002	2001
Cash paid during the year for:			
Interest	$ 1,481	$ 1,216	$ 2,167
Income taxes	25,773	26,936	25,168

Board of Directors

Richard M. Frank

Richard T. Huston

Michael H. Magusiak

Tim T. Morris

Louis P. Neeb

Cynthia I. Pharr Lee

Walter Tyree

Raymond E. Wooldridge

Officers

Richard M. Frank
Chairman of the Board/
Chief Executive Officer

Michael H. Magusiak
President

John R. Cardinale
Executive Vice President
Development and Purchasing

Gene Cramm
Executive Vice President
Games, Entertainment,
Franchise and
Concept Evolution

Mark A. Flores
Executive Vice President
Operations

Richard T. Huston
Executive Vice President
Marketing

Thomas W. Oliver
Executive Vice President
General Counsel

Randy Forsythe
Senior Vice President
Operations, Northern Region

Christopher D. Morris
Senior Vice President
Chief Financial Officer

Sandra J. Brown
Vice President
Payroll, Accounts Payable
And Inventory

Kenny L. Bullock
Vice President
Real Estate

Joe Elliott
Vice President
Research And Development

Marshall R. Fisco, Jr.
Vice President
Legal and Corporate Secretary

Steven Hatton
Vice President
Operations, Field Support

Michael H. Johnson
Vice President
Purchasing

James Mabry
Vice President
Controller
Treasurer

Catherine R. Olivieri
Vice President
Human Resources

Ahmet Oner
Vice President
Management Information
Systems

Lois F. Perry
Vice President
Advertising

Jon Rice
Vice President
Marketing

Odom Sherman, Jr.
Vice President
Taxes

Jeff S. Smith
Vice President
Operations, Western Region

Gary Spring
Vice President
Operations, Midwest Region

Mark Wallace
Vice President
Operations, Southern Region

Alice Winters
Assistant Corporate Secretary

The officers identified above are employed by CEC Entertainment, Inc. and its subsidiaries.

Corporate Information

Executive Offices
4441 West Airport Freeway
P.O. Box 152077
Irving, Texas 75015
972/258-8507

Annual Shareholder Meeting
May 20, 2004
9:00 AM
Dallas / Fort Worth Airport Marriott South
4151 Centreport Drive
Fort Worth, Texas

Stock Transfer Agent and Registrar
Equiserve Trust Company, N.A.
P.O. Box 43023
Providence, Rhode Island 02940-3023
877/498-8865

Stock Listing
The Company's common stock is traded on the New York Stock Exchange under the symbol "CEC."

Independent Auditors
Deloitte & Touche, LLP
2200 Ross Avenue
Suite 1600
Dallas, Texas 75201

10-K Availability
The company will furnish any shareholder, without charge, a copy of the Company's annual report filed with the Securities and Exchange commission on Form 10-K for the 2003 fiscal year (including the financial statements and schedules thereto) upon written request from the shareholder addressed to

Secretary
CEC Entertainment, Inc.
4441 West Airport Freeway
P.O. Box 152077
Irving, Texas 75015

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Squires & Company » Dallas, Texas

CEC

entertainment, inc.

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2003 ANNUAL REPORT

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